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SUBJECT: GVN TO CONTINUE ECONOMIC STIMULUS AS INFLATION CONCERNS
MOUNT

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¶1. (SBU) Summary: Vietnamese financial officials told visiting Treasury Department Director of South & Southeast Asia Malachy Nugent on July 15 that the government's economic stimulus plan had helped buffer the impact of the global downturn. They said the GVN for now had decided to continue its stimulus package until the end of the quarter given continuing uncertainty about the global economy. However, it recognized that the stimulus had created growing inflationary and currency risks. Funding of the government deficit remained a concern. The IMF Representative said he doubted actual stimulus spending would reach announced levels but expressed concern that recent credit growth could increase NPL's over the medium term. End summary.

SBV: Stimulus Successful, Inflation a Concern

¶2. (SBU) State Bank of Vietnam (SBV) Vice Governor Nguyen Van Binh briefed Nugent on Vietnam's struggle with inflation last year and the subsequent impact of the global slowdown on Vietnam's export demand and output levels. Binh lauded the effectiveness of the GVN's stimulus package and highlighted its contribution to the improvement in second quarter GDP. He asserted that the interest rate subsidy had been critical to increasing credit growth from negative figures during the first several months of this year to 17 percent growth by the end of the first half. He did, however, note that the SBV is closely monitoring the impact of the stimulus on inflation and the negative pressure it has put on the Vietnamese dong. He said the GVN plans to gradually reduce the stimulus program when there is evidence the Vietnamese economy is returning to its natural growth path. Monetary policy would be "flexible but prudent." He foresaw a budget deficit this year of about 5 percent of GDP and said there were positive signs the GVN would not have to use all of the announced \$8 billion stimulus package.

¶3. (SBU) In response to Nugent's inquiry about the impact of recent credit growth on the volume of Non-Performing Loans (NPLs) in the banking system, Binh expressed confidence in the underwriting standards of the State banks as well as the prudence and caution exercised by the growing number of commercial banks. He noted that the SBV tracks NPLs very closely, adding that they were 2.85% for the first half of 2009 with worse case scenario predictions of 4.0% for the entire year. Binh cited the GVN's experience during the Asian financial crisis, when it successfully managed significant NPLs and bank closures despite a lack of formalized procedures. However, he admitted that "legal structures and procedures are lacking." He said pending financial legislation would help address these weaknesses and permit the government to legally take over failed institutions.

¶4. (SBU) Nugent concluded the meeting by providing a brief U.S.

macroeconomic update and reiterated Treasury's commitment to assist the continued development of Vietnam's financial institutions. Binh responded that the SBV welcomed additional technical assistance on anti-money laundering, the development of its capital markets and banking activities, as well as additional human resource training.

MOF: Funding the Rising Deficit is Problematic

15. (SBU) Ministry of Finance Banking and Financial Institutions Deputy Director Nguyen Ngoc Anh provided a brief summary of current economic conditions and hailed the success of the GVN's stimulus plan at buffering the impact of the global downturn. He said the GVN had heard the concerns expressed about a revival of inflation and had debated internally whether to begin dialing back the stimulus program. It had decided to maintain the program until the end of the current quarter given significant uncertainty about the global economic outlook.

16. (SBU) Anh noted that funding the stimulus remains a challenge and that the fiscal deficit could reach as high as 7.0% of GDP in 2009. Anh noted the successful offering in Vietnam of \$230 million of dollar denominated bonds but the failure this year of Vietnamese dong offerings. In coordination with the SBV, the MOF has explored international issuance and concluded that foreign investors "are just not ready" and costs would be too great. Anh said the GVN could in part fund its deficit by using funds already allocated but not yet spent. He said, "We will look in our pockets first before we borrow more."

17. (SBU) Anh expressed confidence in the health of the Vietnamese banking sector. He said he was not concerned with increased credit growth or risks presented by NPLs. The SBV has been very outspoken regarding loan quality and has done extensive auditing of Vietnam's financial institutions. In response to a question, Anh said the

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latest draft Law on Credit Institutions that contained a lending limit for individual commercial bank clients did not discriminate against foreign banks. The MOF believed the requirement was necessary given recent experience with the financial crisis and concerns about the strength of foreign financial institutions like AIG.

Think Tank: Significant SOE Reform Needed

18. (SBU) President Nguyen Quang A of the Institute of Development Strategy detailed the changes in economic policy over the last 18 months and expressed concern that the current overextension of credit could lead to significant inflation in 2010 if the economy overheats and world commodity prices rebound. He asserted that Vietnam's significant fiscal deficit is not unavoidable as the GVN claims, but is, rather, largely a result of inefficient use of capital by SOE's. He noted that there are deep rooted problems in the economy and that long term strategies and reforms are needed. At the same time, he said that continued rapid growth of the private economy would reduce the role and significance of the SOE's over time.

NFSC: Banks Remain Healthy

19. (SBU) National Financial Supervisory Committee Chairman Le Xuan Nghia said that the global financial crisis has had little impact on Vietnam's financial institutions because they are still underdeveloped and not highly integrated into the global market. He stated that depositors remained confident in Vietnam's banks due to an implicit 100% guarantee provided by the government and that the sector has only felt minor liquidity strain. Nghia said that bank profitability remains strong and that ratios such as capital adequacy, NPLs, return on equity, and return on assets are stable and not of concern. Nghia stressed that Vietnam's financial supervisors are more conservative than those in other countries and focus more on risk management and protection of depositors' interests, rather than the interests of shareholders.

IMF: Political Pressures Drives Stimulus

¶10. (SBU) IMF Country Representative Ben Bingham told Nugent that in its stimulus plan the GVN had to provide sufficient stimulus without sparking concern among market participants about deficits and local currency strength. The GVN had announced between \$8 and \$9 billion in stimulus, but it remained unlikely the total amount dispersed would reach those levels. There was political pressure to appear aggressive in the wake of the global economic downturn. However, current budget constraints were unlikely to permit the levels of stimulus discussed.

¶11. (SBU) Bingham said he expected the banking sector to remain stable for at least the next six to twelve months. However, as the private banking sector continues to develop and modernize, Vietnam will need to develop a more robust regulatory structure. The few audits that are performed are inadequate and there are virtually no structures in place to address problem banks. The IMF believes the GVN's estimates of NPLs remain too low and that actual loan performance is significantly worse. Furthermore, Bingham said he expected significant credit growth over the last six months will have a negative impact on NPLs in the medium term.

¶12. (SBU) Comment. GVN financial officials appear to have heard the recent warning messages from the private sector and IFI's regarding growing inflation and currency risks created by the stimulus package. While the GVN has not yet said it will start unwinding its expansionary measures, it seems to be taking steps to rein in credit growth. On July 16 SBV Governor Nguyen Van publicly noted inflationary dangers, announced that the SBV would monitor bank lending more closely, and directed that credit institutions tighten lending to real estate and stock investors, as well as to consumers. He stated that lenders should focus instead on extending loans to small and medium-sized enterprises to boost production.

¶13. This message was cleared by Office Director Nugent.